



## Early Journal Content on JSTOR, Free to Anyone in the World

This article is one of nearly 500,000 scholarly works digitized and made freely available to everyone in the world by JSTOR.

Known as the Early Journal Content, this set of works include research articles, news, letters, and other writings published in more than 200 of the oldest leading academic journals. The works date from the mid-seventeenth to the early twentieth centuries.

We encourage people to read and share the Early Journal Content openly and to tell others that this resource exists. People may post this content online or redistribute in any way for non-commercial purposes.

Read more about Early Journal Content at <http://about.jstor.org/participate-jstor/individuals/early-journal-content>.

JSTOR is a digital library of academic journals, books, and primary source objects. JSTOR helps people discover, use, and build upon a wide range of content through a powerful research and teaching platform, and preserves this content for future generations. JSTOR is part of ITHAKA, a not-for-profit organization that also includes Ithaka S+R and Portico. For more information about JSTOR, please contact support@jstor.org.

## THE TRUST PROBLEM—PREVENTION VERSUS ALLEVIATION<sup>1</sup>

For something over two decades we have had on the statute books of this country a law which forbade all combinations in restraint of interstate commerce. During the greater portion of this period, too, most of the states have had laws which distinctly forbade the formation of trusts and monopolies. Taken together, this legislation, not to mention the common law, would appear to cover fairly well the possible field of trust activity. What has been the result? Occasionally one of these combinations has been driven from a state or obliged to dissolve, but sooner or later there was usually discovered an organization which, however different in outward appearance, still behaved in a manner most suspiciously like the old banished trust. In fact, not only were the old trusts not effectually broken up after the passage of this legislation, but new trusts were formed more rapidly than ever before. Thus we may fairly say that, up to last year, the trusts, after twenty years of laws which were supposed to annihilate them, had become more numerous, stronger, and more firmly intrenched than ever before. Last year, among others, two of the most prominent of these trusts were declared illegal and they are now being broken up into parts. Yet there are many who, in view both of past experience, and of the apparent opinion of the business world so far as reflected in the stock market quotations for securities of these trusts, are pessimistic enough to assert that this time too we shall obtain only another change of form. Moreover, there are still others who declare that even if the purpose of the law be at last attained, nevertheless the whole policy of annihilation which underlies our laws is wrong and should be reversed. In view of these circumstances is it not time to inquire: Are we going at this problem in the right way? Whether we agree that the policy of annihilation is right or that it is wrong, in either case this question should be raised. If the policy is wrong, why is it wrong and what other policy should be adopted? If it

<sup>1</sup> A paper read before the Western Economic Society at Chicago, March, 1, 1912.

is right, why has it not accomplished more, and by what other method of procedure can we hope to secure better results?

Far be it from me within the limits of this paper to attempt to give a complete answer to either of these questions. I do wish, however, to suggest certain points which seem fundamental in any consideration of these questions—points which as yet have not received sufficient recognition in the general discussion on this subject, although they involve questions the decision of which must be a preliminary to any detailed plan of attacking the problem.

First of all—and this is really the chief point which I have to make—I submit that any plan for solving the trust problem, if we are to secure substantial and lasting results, must be based on preventive rather than alleviative methods. The suggestion is such an obvious one that I should hesitate to occupy time with it were it not for the fact that the point has been so commonly ignored. The whole trend of development in the study of such subjects as medicine or criminology is to emphasize the importance of preventive measures in contending against the evils with which they deal. If the country is threatened with a plague we are not satisfied to wait until a person is stricken and then send him to the pest-house: we try to prevent it in the first place. In the case of the trust evils, on the other hand, we sit calmly down and wait until it is supposed that a trust has gained possession of an industry. In the course of time the administration may conclude that the trust ought to be sent to the courts for treatment. The courts spend from one to five years deciding whether they have a right to treat the case. Then, if perchance that point has been decided in the affirmative, the court either fumigates or dissects according to circumstances. In the meantime, while this procrastinating process is being worked out, the community has suffered from the continued gathering in of monopoly profits by the trusts; the infection has spread, and more cases of the evil have broken out in the form of new trusts in several other lines of industry. Is there any other field of science in which we go at the task of remedying an evil in such a backhanded and antiquated manner? No wonder so little has been accomplished. No wonder the trusts have waxed stronger and the problem seems as far from solution as ever. What more

could we expect from such a method of procedure? True, the passing of laws saying that the trusts shall not exist may alleviate the trouble, provided the laws are enforced; but I repeat, we can never effectively and permanently get rid of the evil until we adopt methods which are preventive.

A resort to preventive methods involves a careful study and investigation of the problem. Doubtless this is one reason why such a method has not been resorted to before, for legislators are seldom inclined to give such a question the amount of study which it requires: it is so much easier to draw up a statute simply forbidding the existence of the evil. Such an investigation means getting at the roots of the evil and attacking it there. This necessitates an analysis of the causes for the growth of trusts, the point to which I now turn. The great light which such an analysis throws on the methods of procedure in attacking this problem, and especially the light which it throws on certain tendencies in much of the recent discussion which I cannot but consider as misdirected, will well justify some detail. Since among these mistaken tendencies there is found the very natural one to overemphasize certain of the more immediate causes while neglecting the others, we will start our analysis by attempting to distinguish between the more obvious and immediate causes and those which are more underlying and fundamental.

The latter group of causes may perhaps be classified under three heads, given in the order of their importance: (1) the desire to secure the exorbitant extra profit above the normal which comes with the power of monopoly; (2) the effort to save the excessive wastes of competition; (3) the wish to obtain the advantages of large-scale production. Fundamentally, the trust movement is the resultant of these causes working themselves out under the conditions which prevail in modern capitalistic industry. Just what those conditions are it is desirable to examine for a moment, so that we may determine more exactly the forces against which we shall have to contend if we would destroy the trusts.

A brief glance at the changes in the organization of industry which have taken place during the nineteenth century will make the situation plain. A steady widening of the market due to improved

means of transportation has made possible a larger scale of production and this growing scale of production has been furthered by the rapid introduction of machinery, for machinery is only economical when used on a relatively large scale. Where this situation existed the corporation was introduced as the prevailing form of business organization, since it better than any other form facilitated the gathering together of the large amounts of capital necessary and at the same time offered the most effective means of management. These things in turn set in motion tendencies such as the localization and integration of industry, which also facilitated concentration of control and combinations. Further changes were made in the corporation laws, many of them specifically designed to promote this tendency, the most important being the introduction of the holding company. The increasing size of the business unit brought about a steady decrease in the number of units and thus control of the output came to rest to a greater extent than ever before in the hands of a few.

The characteristics of modern industry thus far noted chiefly serve to explain the growing scale of production. They are closely connected with the causes for the increased wastes of competition and the natural desire to save those wastes, to which we now turn.

One important result of production on a large scale is the very small margin of profit per unit of product which results. When sugar is refined on a margin of profit of  $\frac{1}{8}$  of a cent a pound or oil at  $\frac{1}{2}$  cent a gallon and woolen cloth is manufactured at a margin of 1 cent a yard, it is obvious that a very slight fluctuation in price means enormous losses or gains. Consequently it becomes all the more important to the producer to prevent those slight fluctuations in price to which the modern market with its sensitive organization is particularly susceptible, while at the same time the incentive to raise the general level of prices even a little becomes greater than ever.

There are several features of modern industry which tend to cause some difficulty in bringing about the proper adjustment of demand and supply and hence tend to create these fluctuations in price. The modern market is much broader than formerly and hence more difficult to forecast. The processes of production are

more roundabout and require a longer period of time, which again makes it more difficult to foretell market conditions. Also specialization has made the processes more interdependent and complicated so that the need of careful control and adjustment is correspondingly increased. Still another difficulty arises from the use of ever-larger quantities of fixed and specialized capital which when once invested in an industry cannot be withdrawn without very heavy losses. As a result, when profits fall below the average, competition becomes the more severe and the losses so much the greater. All these features of modern industry, it will be seen, only work to enhance the desirability of securing control over the industry, if for no other advantage than better adjusting the output to the market conditions.

To sum the matter up: we have in modern capitalistic industry tendencies toward a widening of the market with increased localization and integration and a steadily enlarging scale of production accompanied by a growing fierceness of competition. The larger the concerns, the smaller their number, the greater their resources for carrying on a fight, the bigger the prize which goes to the winner, and consequently the fiercer the competition and the more excessive its wastes. Add to this the difficulties arising from the small margin of profit, the more complicated and prolonged industrial processes, the wider market, and the large use of fixed capital —difficulties which still further increase the competition and losses and offer all the more incentive to combine for purposes of control —and finally add the extra gain which comes from the power of monopoly to extort exorbitant prices, and one understands the forces which are fundamentally responsible for the modern trust movement. The points here suggested are not particularly novel but they need to be emphasized, for they are the forces against which we must contend if we would destroy the trust. These forces, however, cannot be held chiefly responsible for every trust, though they unquestionably explain the basis of the general movement. The reason for many trusts may be found in more immediate causes, which, for the very reason that they are more immediate and obvious, have often appeared, to the public eye at least, as even more important. The more prominent of these may

perhaps be classified into three groups: (1) the profits of promotion; (2) special privileges; (3) certain methods of competition. They will be taken up in order.

It is doubtless true that a considerable number of trusts owe their origin to the profits which it was expected would accrue to the promoter who undertook the task of organizing the trust. This was especially the case in the promotion which went on during the years 1898 to 1901, when the money market and other conditions were particularly favorable; but it is not likely that we shall soon see a recurrence of such an era. There can be no question, however, that the lax corporation laws, many of which appear to have been especially designed to meet the promoter's needs, did enable him to make certain gains and to dispose of the securities put out at a somewhat higher price than would otherwise have been possible. Still, it must be borne in mind that the more fundamental causes for the growth of trusts were really at the bottom of even these gains. It was primarily because people believed in these advantages of large-scale production, the saving of the wastes of competition, and the extra profits of monopoly that the promoter's gains were possible. Had the laws been more strict certain opportunities for profit would have been cut off and others lessened so as to reduce them to a more legitimate basis, but the fundamental causes would have still remained. Thus at best this is only a minor cause for the growth of trusts.

Most prominent among the second group of more immediate causes for the growth of trusts—those which I have called special privileges—are railroad favors, tariff duties, and patent rights. In former years railroad favors of one sort or another were doubtless given to many of the trusts. From time to time announcements have been made that these discriminations had been abolished; but frequently, as some later special investigation or prosecution revealed the facts, it has been found that they still existed. However, the evil is undoubtedly much less frequent than formerly and today is at best but a minor factor. The tariff is probably of more importance as an aid to the trusts, though I am inclined to believe that its influence has been considerably exaggerated. Probably its chief effect is in enabling trusts, most of which would exist in

any case, to exact somewhat higher prices for their products than would otherwise be possible. It should be noted, however, that it is not the reasonably protective tariff, just equaling the difference between the costs of production in two countries, but the over-protective tariff which offers the chief incentive for the formation of trusts. It is because the duties are often so much higher than is necessary to maintain the industry that overproduction ensues and the domestic manufacturers are led to combine so as to secure the high profits made possible by the tariff. To enact duties of this character is to do nothing less than to offer a reward for forming a trust. The importance of patent rights as a basis for trusts probably deserves more attention than it has received. We must recognize, of course, that the patent itself is a monopoly created for the public benefit. But it was not until recent times that the patent right on some important machines was bought up and left unused so that no rival could get it, or was employed to hold up a whole industry as in the system of leases of the United Shoe Machinery Company, or that it became a weapon for forcing the formation of a pool or association in an industry as in the case of the "bathtub" trust. The theory of public welfare underlying the gift of patent rights certainly never contemplated their use in such ways as these.

The third group of minor causes for the growth of trusts includes certain methods of competition, notably factor agreements and discriminating prices. Under such an agreement the manufacturer or wholesaler may sell his product on condition that the price which he fixes be absolutely maintained, or on condition that the retailer shall not deal in the competing product of any rival, or perhaps that he shall not sell such rival product below a certain price. Any concern putting out a product for which there is a considerable demand can use this system, especially the latter form, against its rivals with tremendous power and effectiveness. The practice of discriminating prices—fixing low prices, often less than cost, in sections where a rival product is sold, and making up the loss by selling at a high price in other sections—is also a powerful weapon for building up and maintaining monopoly control. When used by smaller concerns similar methods appear to be simply a normal form

of competition; but when a concern has attained large proportions or has once entrenched itself in an industry these methods backed up by the power of large capital prove to be a most destructive force—witness the Tobacco Trust. An independent concern, no matter how efficient, will hesitate long before subjecting itself to the enormous losses which inevitably follow any attempt to force the trust from its stronghold.

Closely connected with this is the power exercised by control of credit which is sometimes declared to be an important weapon of the trust. On this point it is impossible at present to speak decisively. Information is very difficult to obtain and usually conflicting. There is some reason to believe that a large concern with the close financial alliances which ordinarily accompany it may occasionally find itself in a position where it can control the credit obtainable by a rival at some crucial moment and through the power thus obtained may force that rival to capitulate, often at a heavy loss, as in the case of the Pennsylvania Sugar Refining Company. There may not be a money trust but apparently there are times when the power of centralized control over large masses of capital proves of great advantage to a big corporation. Our present information, however, would not justify us in considering this a factor of appreciable importance in the growth of trusts.<sup>1</sup>

Having now completed our survey of the causes for the growth of trusts we may well stop and ask, What of it all? The analysis itself cannot be said to have disclosed anything startlingly new but it may be justified if it leads to some definite conclusions. It is believed that if we are to adopt preventive methods in our attempt to solve this problem, this analysis does lead to certain conclusions as to the best line of procedure which are of fundamental importance.

The first point to which I would ask your attention is one which I conceive to have been the cause of very widespread confusion in the discussion of this subject: the failure to see that we have really

<sup>1</sup>Let it be noted, however, that in the case of these practices as well as in the case of the other causes for the growth of trusts I am not pronouncing on their desirability but simply pointing out their importance in furthering the organization of trusts.

two problems to deal with, the corporation problem and the trust problem. These are two separate and very distinct questions. The heart of the trust problem, as I view it, centers about the control of monopoly price; the corporation problem, on the other hand, is primarily concerned with maintaining proper relations and protecting the respective rights of the officers, creditors, and investors in such a form of corporate organization as shall prove suited to the real needs of modern industry. It is frequently asserted that if we could once prevent stock-watering, control the issue of securities, and better supervise the operations of the promoter either by federal incorporation or otherwise, then the trust problem would be solved. The explanation for the confusion on this point in so much of the current discussion is to be found in the fact that many of the trusts afford the most notorious examples of these corporation evils. But this overlooks two things: first, that these evils are quite as common among corporations which can make no pretense to monopoly; second, that there are many trusts which either have never been responsible for these corporation evils or have never taken the form of a corporation at all. Therefore I beg to submit that, on the contrary, you may totally abolish all the evils of the corporation, stock-watering, manipulation, defrauding creditors, injuring minority stockholders, excessive promoters' profits, and all the rest, and you will still have the problem of trusts on your hands. Conversely, if you were so successful as to abolish all the trusts in creation, you would still have to face these evils which are due to our lax corporation laws. If we wish to progress in our discussions of the trust question, it is time we began to discriminate between these two problems.

In saying this, however, I do not wish to imply that there is no connection between the two. And here is where our previous analysis helps us. As that analysis indicates, the opportunities for capitalizing and obtaining the profits of monopoly are made easier by our corporation laws, and the profits of the promoter are among the causes for the growth of trusts. Even more important, however, is the device of the holding company. A reform of our corporation laws which regulated these abuses would therefore aid in a solution of the trust problem. But inasmuch as our analysis

showed these to be among the less important causes for the growth of trusts, it is clear that such remedies could play only a very minor part in helping us out of our difficulties.

A second conclusion to which I would draw your attention is that certain of the causes which lead to the growth of trusts are causes which may lead to a desirable form of growth—a growth based on social efficiency. Thus the advantages of large-scale production and at least many savings of the excessive wastes of competition, to mention the most prominent, are socially desirable. In so far as trusts have grown up based on these causes they are in a position where, potentially at least, they can serve the public better than anybody else. It does not necessarily follow that they do so, but we should recognize the possibility. There is, I believe, this element of good in nearly every trust; it may be very small in most, but I believe it is there. It is hardly likely that so fundamental a tendency in the organization of modern industrial society as this would be without some element of value in it.

The present anti-trust law, even under the recent rule-of-reason interpretation of the Supreme Court, adopts a policy of destruction of all trusts declared unreasonable. In the eyes of the law all trusts are either black or white—there is an underlying assumption that a trust is either reasonable, in which case it is let alone as being altogether good, or it is unreasonable, in which case it is destroyed as altogether bad. What proof have we that this assumption is correct? In fact, our analysis has shown there is every reason to believe that in most cases it is incorrect. I conclude, therefore, that we should draw our line of distinction, not between so-called reasonable trusts and unreasonable trusts, for that method can only give the most crude results, if indeed it has any desirable results, but rather between causes of growth which are based on social efficiency and lead to socially desirable results and those which do not lead to survival through efficiency. In other words, we should apply to each of the various causes which our analysis revealed this test: Does it lead to a growth based on superior efficiency in serving the public? If so, let the trust grow unhindered so far as this cause is concerned; but if growth is not based on social efficiency, then take measures to do away with the

cause. In that way we should put into operation a socially selective force which would strike at the real roots of the evil in a discriminating manner.

If, as some claim, all the trusts are based on some special privilege or unfair method of competition, then this method of procedure would eliminate them all and, *what is more important, it would prevent such trusts from coming into existence in the first place.* On the other hand, if, as many believe, there is an element of good in the trust, we should at least give it a chance to show itself. In case any trusts survived or new ones grew up, we should know that it was because they were socially efficient. We should at least have the satisfaction of feeling that we had not summarily cut ourselves off from possible advantages by destroying the whole structure because we did not like certain of its aspects. In short, we should try reformation, not annihilation—and reformation which starts with preventive methods, that discriminate between what is potentially good and what is potentially bad. The advantage of this line of attack is that, whether you believe the trusts to be partly good or altogether bad, in either case such a method is the most effective for securing the desired results.

This conclusion is further strengthened by reasoning from yet another point of view. For does not our analysis of the causes for the growth of trusts suggest that the problem of the modern industrial trust has features which are strikingly similar to those of a problem which we have met with elsewhere? In fact, if we will but recognize the real nature of our problem and then look about, I believe we can discover excellent precedents to guide us.

The search will not carry us far, for we shall at once find that fundamentally there is a very close resemblance between the economic conditions which prevail in an industry where the trusts have developed and the situation which exists in such industries as railroads, gas, electric light, and telephone. There we find that the scale of production which is most efficient is often so large that one concern will supply the whole market; the wastes of competition are so excessive as to make competition undesirable if not intolerable. There, too, we see the influence of the same small margin of profit, the same large amounts of fixed capital, and the same need

for adjustment of output to market conditions. Not only are there these striking similarities in fundamental conditions, but also in immediate causes there is a marked correspondence. We discover in these industries too the influence of overcapitalization and promoters' profits; we find special privilege in franchises and other favors; we recognize in railroad rebates and discriminations a strong resemblance to trust methods of competition. Admittedly these industries are cases where the process has gone farther and the characteristics are more marked, but the difference, I am confident, is one of degree, rather than kind; fundamentally they are essentially the same. And why not? Is it not within the bounds of the conceivable that a situation might arise where one telephone company could supply the whole country as well as a whole city, at a lower cost and with better service than several companies? Is it not also possible that one oil company with its great system of pipe lines and refineries could do the same in the case of oils or a steel company in the case of steel? I do not say that such is the case; I do not know; we have not facts enough to tell as yet. It is at least suggestive, however, that the most thorough investigations yet made—those of the Bureau of Corporations—report that the large concerns which dominate the oil and steel industries are able to produce at lower costs than any independent. True, this may not be transmitted to the public in the shape of lower prices, but our point rests on simply showing the existence of a potential social gain. If, then, our analogy is correct and we have such a precedent, why should we in the case of the trusts adopt methods of procedure so diametrically opposed to those in the other case? Why annihilate the trust and regulate the gas company? Conversely, if we split up the trust into parts, why not do the same with the gas company? If we have abandoned the policy of compulsory competition in favor of regulation in one case, why not in the other? It may be replied that in the case of the railroads we have not altogether done this. Yet economists are agreed that the policy of forbidding railroad pools is a mistake, and only aggravates the evils it was intended to remedy. It is but a relic of the same policy of enforcing competition which now underlies the anti-trust laws, a policy whose advocates

seem to have forgotten that competition originally was looked upon as only a means to an end, and now regard it as an end in itself, apparently oblivious of the fact that it does not under all conditions work out so as to attain the consequences really desired. Finally, if still further evidence be needed, we have but to compare the results obtained in these industries under the policy of regulation, and those obtained under the anti-trust law. That regulation has results to its credit quite beyond any possible claim of the alternative course of procedure is so obvious as to make discussion of the point superfluous. Such being the case, why not adopt the method which precedent shows will best accomplish the desired end? Thus from still another point of view our analysis of the causes for the growth of trusts and the example of successful precedent only lend additional weight to the conclusion that the "trust-busting" policy should be abandoned in favor of trust regulation.

Let me emphasize the point, however, that this does not mean that we should be satisfied with a plan such as will simply regulate the trusts which may grow up or are already in existence. Undoubtedly this alone, carried out perhaps through the agency of a trade commission similar to the public utility or interstate commerce commissions, would be distinctly more desirable and eminently more effectual than the present policy. But a trade commission in itself is hardly sufficient; and, as our conclusions show, it must be supported by measures designed to exercise discriminating prevention in the first place. When we combine these two lines of attack the number of trusts left to regulate will be greatly reduced, and the problem of regulation vastly simplified.

Still another conclusion may be drawn from our study of the causes for the growth of trusts. This is that the question of trusts is complicated and that there is no one panacea, if we could but find it, which would settle all our difficulties at once. The simplest and most sweeping method—that of legislative abolition—we have tried and it has failed. The trust problem is so firmly rooted in our present industrial system that we must attack it from many sides at the same time, whether we desire abolition or regulation. Abolition of the overprotective tariff, reform of corporation laws, federal incorporation, an industrial trade commission—any one of these alone will never get us out of our difficulties.

It will be noted that I have not yet once touched upon the legal difficulties involved. First we must decide in what direction to proceed. But once that is settled, there still remains the problem of devising legislation which will be effective and at the same time harmonize with the constitutional limitations and divided jurisdictions of our federal system of government. Not until we appreciate the real complexity of the problem can we hope to obtain effective and permanent results. To point out the details of such a plan cannot be undertaken here, even if I were prepared to do so. It is believed, however, that in the analysis of the causes for the growth of the problem can be found an indication of the direction in which to proceed if we would effectually rid ourselves of its evils. The thing of first importance is to get started in the right direction. It is toward that end that this discussion has been primarily directed.

To summarize the main conclusions:

1. Any attempt at an effective solution of this problem must resort to preventive rather than alleviative measures. This involves a study of the causes for the growth of trusts.
2. Such a study shows that the trust problem is separate and distinct from the corporation problem, and that the reform of corporation evils would have but slight influence on trust evils.
3. It also shows that (a) since the trusts may have an element of good in them which would be destroyed under the present policy of annihilating unreasonable trusts, and (b) since the trusts show many characteristics which closely correspond to those prevailing in industries controlled by public-service corporations where (c) a policy of regulation has accomplished so much more; therefore, we should inquire whether a policy of regulation discriminating between trusts and trust evils, and based on preventive methods, should not be substituted for our present indiscriminate, purely alleviative, and generally ineffective policy of destruction and enforced competition.

4. Finally, it shows that the problem is deep rooted and many sided, and that whatever policy is adopted we cannot hope to find any simple panacea which will abolish all the evils at one stroke.

CHESTER W. WRIGHT

THE UNIVERSITY OF CHICAGO